On the minds of investors

July 18, 2019

Is the Chinese economy showing signs of improvement?

China's Gross Domestic Product (GDP) for 2Q 2019 came in at 6.2% year-over-year (y/y), in line with expectations but weaker than 1Q 2019 of 6.4%. Year-to-date, GDP came in at 6.3%. Meanwhile, June industrial production (6.3% y/y vs. 5.2% expected), year-to-date fixed asset investment (FAI) (5.8% y/y vs. 5.5% expected) and retail sales (9.8% y/y vs. 8.5% expected) were all better than expected.

In particular, retail sales were mainly led by a jump in auto sales growth (to 17.2% y/y from 2.1% last month, helped by bigger sales discount and base effects), while sales growth of some major goods (such as home appliances, cosmetics and clothing) as well as catering also rose in June.

Total social financing (bank lending and off balance sheet financing) for June rose more than expected at 10.9% (vs. expectation at 10.8%) due to the notable increase in special local government bond issuance, while corporate bond financing also turned up. This is in line with ongoing policy support and the positive impact on infrastructure investment indicated in the latest FAI data. In June alone, fixed asset investment growth accelerated to 6.3% from 4.4%, led by a rebound in infrastructure FAI growth, while manufacturing and property FAI also increased.

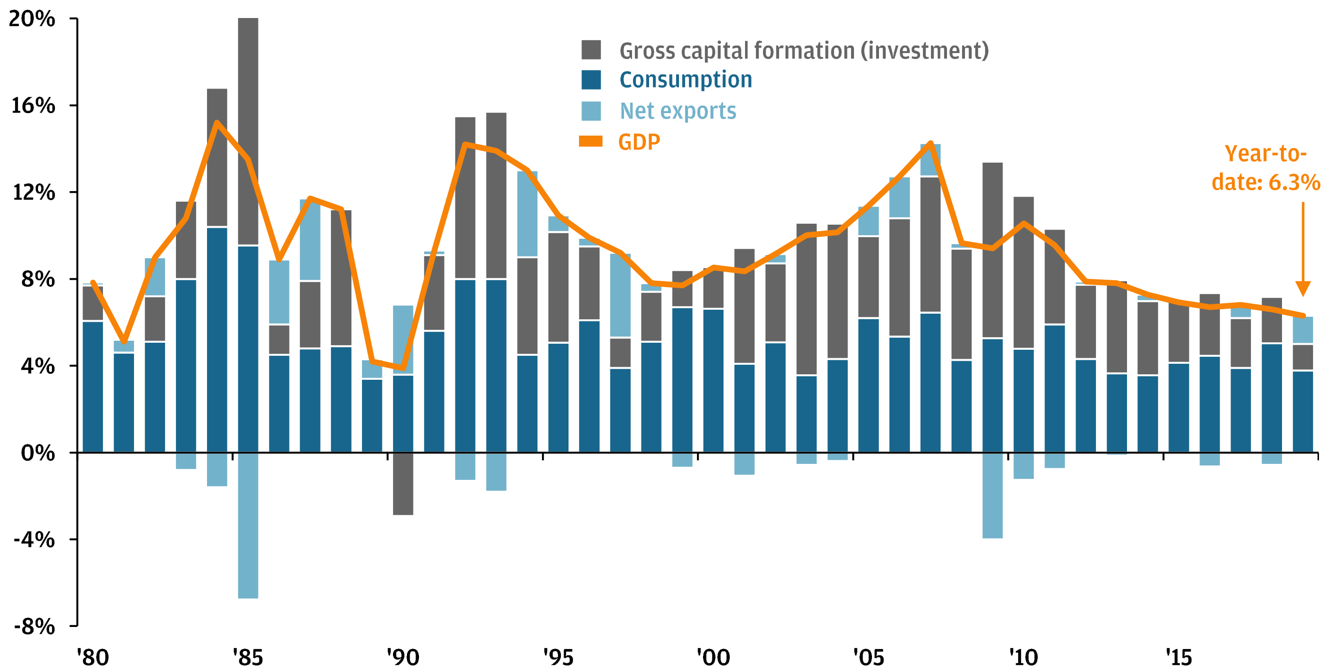
Trade remains the weak spot with June exports and imports falling by 1.3% and 7.3% y/y respectively, vs. +1.1% and -8.5% in May. The major drag came from falling trade with the U.S., as the 25% tariffs on USD 200billion of Chinese goods came into effect on June 15th and exports to the U.S. were down by 7.8% y/y in June. Imports from the U.S. also declined by 31.4%, after China's retaliatory tariffs on USD 60billion worth of U.S. goods kicked in on June 1st.

The upside surprises in June activity and financing data indicate that previously enacted stimulus measures are feeding through and have helped to offer some signs of economic stabilization in the month of June. In particular, not only did investment and industrial production hold up amid ongoing trade tensions, the major improvement in the June data were led by the private sector while domestic demand (FAI and retail sales) was stronger than expected. However, other investors may remain skeptical given the ongoing structural slowdown and cyclical moderation as illustrated by the 2Q GDP reading. Note that China's growth target for this year remains to be 6-6.5% and today's release suggests GDP has shifted from upper end of range (6.4% in 1Q 2019) to the lower end. The market's mild reaction to the strength in June China data seems to speak to this latter opinion.

Marcella Chow
Global Market Strategist

In our view, the recent agreement on ceasefire between the U.S. and China should help prevent further escalation in trade tension in the near term. However, in order to counter the negative external shocks and ensure stability, we continue to expect policy easing, especially in infrastructure investment and targeted liquidity support, in the coming months. In addition to the special local government bonds, a new round of debt swaps is being implemented to relieve the debt burden on local government financing vehicles. Further expansionary measures are also likely to be taken by the Ministry of Finance, and the PBoC might cut the Reserve Requirement Ratio twice, likely by 25 bps each time, in the remainder of the year to provide credit support for small and medium enterprises as well as targeted sectors.

EXHIBIT 1: China Economic Snapshot
CONTRIBUTION TO REAL GDP GROWTH, YEAR-OVER-YEAR CHANGE



Source: CEIC, National Bureau of Statistics of China, J.P. Morgan Asset Management.
Guide to the Markets – Asia. Data reflect most recently available as of 15/07/19.

Investment implications

In the current environment, investors are advised to take a more active approach in sector and company selection within China. We prefer sector leaders which are more domestically-driven and have less exposure to the uncertainty of the still-unresolved trade tensions. Current valuation of Chinese stocks remain attractive to long-term investors and improving data should help strengthen the fundamental case for A-shares. Meanwhile, demand for income and yield will continue to rise as central banks such as the U.S. Federal Reserve, European Central Bank and People's Bank of China maintain an easing bias. Investors may consider the yield pick-up offered by global high yield and emerging market, including China bonds.

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Material ID: 0903c02a8264a3c4

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